No. 14,695

United States Court of Appeals

For the Ninth Circuit

MID-STATES INSURANCE COMPANY, a corporation, and THE ANGLO CALIFORNIA NATIONAL BANK OF SAN FRANCISCO,

Appellants,

vs.

AMERICAN FIDELITY AND CASUALTY COMPANY, INC., a corporation, THE AMERICAN PLAN CORPORATION, a corporation, MARK HART, JOSEPH LOTZ, RALPH L. SMEAD and L. SUDEKUM,

Appellees.

Appeal from the United States District Court for the Northern District of California, Southern Division.

BRIEF FOR APPELLEES AMERICAN FIDELITY AND CASUALTY COMPANY, INC. AND THE AMERICAN PLAN CORPORATION.

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INTRODUCTION.

Though all defendants are listed as appellees in the title, actually the only appellees are American Fidel-

ity, American Plan, Joseph Lotz and Ralph L. Smead, who were the only defendants served.

This brief is presented for appellees American Fidelity and American Plan. It is in reply to the briefs of both appellants, Mid-States and Anglo Bank.

The basic issue of whether a conspiracy to defraud existed is common to both appeals. Other issues relate to Anglo alone. We will first treat the charge of conspiracy, responding to the arguments of both appellants on that subject. We will then discuss the issues peculiar to Anglo.

ARGUMENT.

I.

THERE WAS NO CONSPIRACY TO DEFRAUD.

A. THE TRIAL COURT'S FINDINGS.

To keep this brief within bounds, we omit a comprehensive statement of facts, and instead we respectfully refer this Honorable Court to the findings of the trial court (R. 114-140) and to its opinion. (R. 97-114.) Of these, we refer to the following:

The court found in substance that with Mid-States' knowledge and permission, Lotz used premiums for his operating expenses and sub-agents' commissions, which amounted to 15.4% and 26% respectively, and he commingled all funds freely; that Mid-States considered him an "independent contractor" in respect to keeping his books and bank account; and that he was almost always overdue in remitting to Mid-States.

From such facts the court found that premiums were not trust funds but money belonging to Lotz. (R. 120-123.)

Mid-States was entitled to 14% of premiums. The remaining 86% was subject to Lotz's expenses and to claims, any balance being commission to Lotz (payable after the loss experience was determined). Lotz's loss ratio ran from 64% to 68% and his expenses in excess of 40%, thus resulting in a loss to him of over $20.00 on each $100.00 of insurance written by him. Moreover, as the court found, Mid-States knew Lotz was unreliable; yet Mid-States urged him to write more business. From these facts the court found that Lotz was not guilty of concealment and that Mid-States was largely responsible for its loss. (R. 124, 125.)

The court found that although there was an excess of liabilities over assets in the Lotz agency on August 1, 1951, Lotz's books were in a chaotic and incomplete state and ill equipped to show the true financial position of the agency, and that therefore defendants did not know that Lotz was insolvent or unable to meet his obligations until about December 1951; and that as late as the latter part of November 1951, Lotz and Hatfield (Manager of Mid-States) thought that Lotz would be able to pay his obligations. (R. 125, 126.)

The court found specifically and in detail that no plan or conspiracy to defraud Mid-States or Anglo Bank was entered into or carried out by defendants. (R. 126-135.)

As to the $61,000 rewrite, the court found that the statements by Hart, President of American Plan, to Hatfield, in the telephone conversation of November 1, were not made with any intent to deceive and were not relied upon by Hatfield in entering into the contract, and that no fraud or deceit was practiced in that respect. (R. 127.)

In the court's opinion, the court discusses the various issues, pointing out Mid-States' knowledge of Lotz's use of premium moneys for expenses, his commingling of premium moneys with his own and the resultant debtor-creditor relationship between Lotz and Mid-States; the fact that the evidence did not substantiate the allegation that defendants entered into a conspiracy to defraud Mid-States; the fact that the testimony of Hart rebutted "all evidence in the record which attempted to show fraudulent intent on the part of defendants" (R. 107); the fact that Lotz's insolvency became known only after assembling and studying the figures after the period in question; that as late as late November or early December, 1951, Mid-States thought the situation could be worked out and was cooperating with Lotz; that Smead admitted to the court that he lied (under oath) and that the court could "give very little credence to his testimony". (R. 111.) The court concluded that from a study of the entire record, plaintiff had not sustained its burden of proving a conspiracy to defraud, and that "the underlying factor which motivated both insurance companies * * * was to secure all the business possible in this State, and it was this

anxiety for business which caused a great loss to one of them". (R. 113.)

B. THE FINDINGS ARE SUSTAINED BY THE RECORD.

1. The Effect of the Trial Court's Findings.

Mid-States has cited authorities declaring some of the principles governing review of a trial court's findings. There are other principles, too, and while this Court is thoroughly familiar with its powers in this respect, we take the liberty of mentioning a few of these other principles.

In *Earle v. W. J. Jones & Son* (1952), 200 F. 2d 846, this Honorable Court said (pp. 847, 848):

> "* * * we should be reluctant to disturb the finding of the trial court where, as here, the question whether the advances gave rise to debts or to a proprietary interest depends upon the determinative *intent* (emphasis the Court's) of the parties to the critical advances. 'Findings as to the design, motive and intent with which men act depend peculiarly upon the credit given to witnesses by those who see and hear them.' "

In *Ruud v. American Packing etc. Co.* (1949), 177 F. 2d 538, this Honorable Court pointed out (p. 540) that "if * * * findings * * * are sustained by substantial competent evidence the judgment appealed from should be affirmed"; that findings are "presumptively correct and must be sustained unless clearly erroneous"; and that the function of the appellate court is "to review alleged errors of law that may have been committed by the trial court". This Court then added:

> "We are not at liberty to substitute our judgment for that of the trial court, and on appeal that view of the evidence must be taken which is most favorable to the prevailing party, and, if when so viewed, the findings are supported by substantial competent evidence, they should be sustained."

In *Quon v. Niagara Fire Insurance Co.* (1951), 190 F. 2d 257, this Court considered the effect of a finding which involved the question of waiver or estoppel. This Court pointed out that that involved "among other factors, the intention of the party". The Court then discussed the effect of a writing, saying (p. 260):

> "The writing under these circumstances must be viewed in its setting together with all the other evidence in light of the credibility accorded the witness. Here the writing is one of the collateral facts."

This Court then added:

> "The theory that there is some magic in the writing itself and that the construction of writings by an appellate court has some special sanction is applied not only in cases such as this, but to depositions, incidental documents, stipulations before the trial court and other features. None of this is valid. The problem before the court is generally one of fact, and there the findings of the trial court are binding. There are many cases where the construction of writings is a question of law. But here the interpretation of this document was required in connection with many circumstances as a question of fact. There was substantial evidence to support the findings, and

these are not clearly erroneous. No rule of law was violated."

So we submit that the "clearly erroneous" rule and the written evidence doctrine referred to in Mid-States' brief must be considered together with these other principles in the review of the trial court's findings in this case; and that when so viewed the trial court's determinations should be affirmed.

2. Mid-States' Contentions.

Mid-States argues that it was entitled to recover because of a conspiracy of fraud against it whereby, it says, Lotz breached his fiduciary duty toward it. It argues, first, that the premiums on its insurance were trust funds which were wrongfully diverted to American Fidelity, and next, that even if the premiums were not trust funds Lotz breached other fiduciary duties toward it which rendered defendants liable for its loss. It bases its contentions, first on certain written statements and testimony, and then on a course of dealing. We will first treat the statements and testimony, then the course of dealing.

3. The Written Statements and Testimony.

In December, 1951, several written statements were taken from defendant Smead. Defendant Lotz joined in some of these and made one of his own. Of these, the basic story is contained in Smead's statement of December 6th; the other statements are supplemental or repetitive.

In its brief, Mid-States refers to these statements several times, but without summarizing their contents.

Since appellant has not seen fit to state these contents, we will not do so except to say that they include some charges of a plan to deceive.

Examination of the statements discloses that the chief source of them was Smead, Lotz's office manager. This is confirmed by the testimony of Lotz below referred to.

At the trial, Smead testified in accordance with the statements.

It takes little to demonstrate the worthlessness of Smead's statements and testimony. He testified under oath five times in regard to this transaction: in a deposition and in the trial of Mid-States' suit against Anglo, in a proceeding before the California Insurance Commissioner to revoke Lotz's license, and in a deposition and in the trial of this case. Three times he repudiated his written statements, twice he confirmed them. Examples of his self-contradiction are:

At the trial of this case, Smead testified he told Hart in New York that the total receivables of the agency were $75,000.00. (R. 437.) At the Commissioner's proceeding he testified it was represented that the receivables on American Fidelity business alone almost equalled the $240,000 Lotz owed American Fidelity. (R. 550.)

At this trial he testified that Hart in his New York office put through a call from Lotz to Mid-States in Chicago station-to-station, saying he did not wish Mid-States to know Lotz was there in his office. (R. 439.) At the trial of Mid-States against Anglo, he testified that that was not true. (R. 554.)

At this trial, he testified that Hart was asked what would happen when Mid-States found itself in American Fidelity's position and that Hart said he would worry about that if the time came. (R. 440.) At the deposition in Mid-States against Anglo, he said he did not recall the conversation. (R. 557.)

At the trial of Mid-States against Anglo, he testified regarding his December 6th statement that "there were certain small portions that might be true", but that the majority of it "was untrue and very definitely untrue", and also "I don't think that supplement is true either * * *" Then:

> Mr. Garrison (attorney for Mid-States):
>
> "Did you fabricate all this conversation with Mr. Hart and make that up?"
>
> Answer: "Mr. Hatfield and myself did, yes." (R. 558, 559.)

At the trial of Mid-States against Anglo, Smead testified:

> Question: "Now Mr. Smead, is it true or is it not true that Mr. Hart told you to deposit these Public Service funds first in the trustee account and then in the American Fidelity and Casualty Company account at the Central Bank?"
>
> Answer: "It is untrue."
>
> Question: "Did you make that all up when you told it to me in my office?"
>
> Answer: "Mr. Hatfield and I made up all the statements, Mr. Garrison." (R. 560, 561.)
>
> Question: "Did he (Mr. Mead, attorney for Lotz) know that it was all a fabricated pack of lies?"
>
> Answer: "I didn't tell him that until some time later." (R. 564.)

At the trial of this case, after Smead had been faced with these and similar passages in his previous testimony, he was questioned by the trial judge and replied as follows:

> The Court: "If I understand you, then, you admit yourself you lied?"
>
> The Witness: "Yes, sir * * *" (R. 568.)

It is true that Smead testified at this trial that previous testimony of his which was adverse to Mid-States had been given under the influence of Mr. Hart, by whom he was then employed. All that this amounts to is that Smead's testimony varies with the person with whom he is dealing. By this token, the statements he gave Mid-States are as worthless as the testimony he gave against them. In other words, Smead's word is worthless.

Then how about Lotz? Lotz signed some of the statements. But his testimony throws a different light on the subject.

For example, in his testimony concerning the New York conference, he said, "It is pretty hard for me to give any details because I was very much confused and upset." (R. 626.) Smead, he said, did most of the talking. "I was not feeling well. I was unable to talk." (R. 627.) Asked whether anything was then said as to how they could pay American Fidelity, he said: "I don't think we were too much disturbed about working it out." (R. 628.) He did not recall the formula they had, nor that anything was said about using another company's premiums to pay American Fidelity. (R. 628, 629.)

Regarding the written statements, Lotz said: "I was very much influenced by Ralph's point of view because of my mental condition at that time. I wasn't too much on a good equilibrium basis with this worry and other things, physical conditions." (R. 657.)

He frankly disclosed his mental processes. He testified "I had in mind some thoughts and plans, but sometimes my mind gets ahead of what is transpiriting right there; so if I hesitate in these answers, I am not sure, so I don't like to say yes or no." (R. 630.) "At that time," he said, "I wasn't myself." (R. 702.)

He exhibited similar indefiniteness regarding the conferences in Oakland, and in explanation testified: "I was in a very bad nervous condition at that time,[1] so some of these answers I don't know due to the stress I had." (R. 634.) He was "pretty well unstrung" and threw things in Smead's lap. (R. 635.)

Regarding the letter terminating his agency with American Fidelity, he said: "I don't even remember signing it." (R. 639.)

Regarding the December 6th statement of Smead, which he had endorsed as correct, he stated, at a meeting with plaintiff's officials and his attorney, William Mead, "I have no idea really what is in it." (R. 936.)

The portrait is of an insolvent man who signed things that were given to him by officials of a company to whom he was indebted and who had taken over

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[1]This is confirmed by Mr. Titus, President of Mid-States, who testified, "Lotz was, as he testified, very confused." (R. 747.)

his business to liquidate it and who were getting statements for a lawsuit against another company. The pressure was real, for the vigor with which Mr. Hart is charged in collecting his money was being matched by that of Mr. Titus and his colleagues in procuring the desired statements. Lotz was no business man. He was an old baseball pitcher, who had transferred his operations from the pitching mound to selling insurance in used car lots. He was sick, in mind and body. He signed things, but they were prepared by others and he could not even remember what was in them. And, as he said, he was under the influence of Smead.

And there was another thing, of weighty significance. It was the manner of taking the key statement of December 6. It is described by William Mead, who had been Lotz's attorney at that time, and whose reputation and bearing firmly established his veracity. He was a disinterested witness, not having acted for Lotz since January, 1952. (R. 925, 926.) His testimony (R. 926-939) was clear. He said Hatfield came to Mead's office December 5, saying they might sue American Fidelity and asked Mead as attorney for Lotz and Smead to arrange for a statement by them. Mead said he had no objection and telephoned Lotz in Hatfield's presence, telling Lotz of Hatfield's request and asking Lotz to come to Mead's office the next morning at ten and bring Smead. Lotz agreed. Mead told Hatfield, who said that was fine.

The next morning no one appeared. Mead telephoned Lotz and asked what had happened. Lotz

advised Mead that the statement had been taken the night before. Mead asked for it. Lotz said Hatfield had taken it. That evening Mead met with the Mid-States' officials. Mr. Titus had the statement and wanted Lotz to swear to it. Mead told him he was amazed at the breach of the agreement made with him and that if Titus would give up the statement they would then prepare another. He testified: "I do recall very distinctly saying that I had no idea whether the statement itself contained all facts or half facts or opinions or whether it was only a partial story." (R. 934.)

Titus refused. Titus then said he feared signers might deny their signatures. Mead asked Lotz if it was his signature. When Lotz said it was, Mead affixed his acknowledgment (only on Smead's signature, it appears). Titus took the statement. Mead has never read that statement or any other.

Such was the testimony of Mead. It was contradicted by Titus and Hatfield in important particulars. Instead of our case being weakened by that conflict, we think it is greatly strengthened. Our reason is if we start with the credibility of Mead—which we should do because it supports the trial court's finding and comes from a reputable witness—the testimony not only prevails against that of Titus and Hatfield on this issue but incidentally clouds the credibility of the latter on all other issues in the case.

Titus testified that when the statements were shown to Mead the latter did not seem surprised that the statements had been taken and did not rebuke Titus

or Hatfield for taking them; that Mead read them out loud and that changes were made in them. (R. 722, 744, 748.) Hatfield testified that the statement was read orally by Mead, who would stop frequently and ask if there were any corrections and after corrections were made asked Smead and Lotz if they were willing to sign it, which they did. (R. 252, 253.) He said he did not recall asking Mead for a statement or making the appointment with him, and he denied that Mead reproached him for a broken appointment. (R. 368, 369.)

These things are in direct conflict with Mead's testimony. The conflict is too sharp to be accounted for by mere faulty memory. And on credibility, we must assume the court followed Mead, and rightly because whereas Titus and Hatfield were interested witnesses Mead was completely disinterested and a man of proven reputation in his profession.

On the issue of conspiracy, therefore, we are concerned primarily with written statements given by a man whose word is worthless, concurred in by another who was concededly under the influence of the former and so impaired in mind and body that he could not remember what he signed; and the original and basic statement was taken from these parties outside the presence of their attorney and in violation of an agreement with him in that respect. As against these statements, we have the unqualified testimony of Messrs. Hart and Feller, which we now briefly survey.

Hart and Feller.

All the statements relied on to show conspiracy were denied by Mr. Hart under oath. He denied that the origin of the telephone call to Mid-States in Chicago was concealed; he simply told his operator to get Mid-States for Lotz. He denied the asserted reference to Cass, or to what would happen if Mid-States took action, or that there was a plan to use others' premiums, and the various other items relied on as evidence of conspiracy. (R. 765-771.) He testified that it was untrue that he asked Smead to keep his name out of the Public Service transaction (R. 775), or that he told Lotz to deposit Public Service checks first in the Lotz trustee account and then transfer the money to American Fidelity (R. 783), or that he told Smead to destroy teletypes. (R. 789.) He denied that he ever asked Smead to change his statements. (R. 819.)

Mr. Feller, general counsel for American Fidelity, similarly denied all the conversations asserted to have occurred in his presence to show fraud (R. 942-954); and he pointed out that the liquidation agreement of August 22 between American Fidelity and Lotz, which Mid-States interprets as evidencing a fraudulent plan, was actually typed by a secretary at the Central Bank of Oakland who was furnished by Mr. Smith, an official of the Bank, and a copy of the agreement was left with Mr. Smith. (R. 954, 955.)

The charge that at New York or in Oakland defendants knew Lotz was insolvent and would have to take someone else's money to pay defendants was rebutted by Mr. Hart in every respect. In the first place, de-

fendants never examined Lotz's books or got a statement from him. (R. 777, 778; 794, 795; 949.) It would have done little good, because the books were grossly inadequate, the postings not being up to date. (R. 950.) Hatfield himself testified that the books were in "a deplorable state"; that the postings were "far behind (and) you couldn't tell the exact status of the Agency at all", and that it took their auditors a month or six weeks to make an examination of the books. (R. 265, 266.) (Actually it took two months. Testimony of plaintiff's auditor, Horton. R. 616.)

At New York, the situation was this. Lotz owed American Plan about $240,000.00.[2] His receivables on American Fidelity business were reported to be about $140,000. Although that turned out to be mistaken, it then appeared reasonable as explained in detail by Mr. Hart. (R. 913, 914.) In addition, Lotz was going to get a better deal from Mid-States with a 15% prepaid commission; he said he was negotiating for a $100,000[3] loan; and he had a $60,000 equity in his $300,000 unearned premium reserve with American Fidelity.

In these circumstances, Mr. Hart said that while Lotz's cash was strained, there was no great concern that he would be able to liquidate his balance. (R.

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[2]Anglo says that Hart called Lotz to New York because Lotz owed American Fidelity $247,000 and Mid-States $30,000. That is mistaken. He called him because he owed $6,600 on a special transaction and a large May balance would fall due in a few days. (R. 760.)

[3]This figure is referred to by Mid-States as $50,000. Hart testified that the amount was $100,000 (R. 762), and so did Feller (R. 943).

763.) Mr. Feller felt the same way, and so expressed himself. (R. 944.) And so did Lotz. (R. 628.) Confirmation lies in the fact that his agency was not then terminated and Hart went out of town. (R. 771.)

A week later, Lotz not having met his August 15th payment to American Plan, Hart and Feller came to Oakland. Since Lotz had in the meantime gotten a better contract from Mid-States, Lotz's agency for American Fidelity was terminated and he made the liquidation agreement. The plan (except for the September 15th date, which Hart explained was psychological) appeared feasible, as related in detail by Hart. (R. 798, 799.)

The prospects of the loan were real, as indicated by the negotiations with the bank, including the fact that Mr. Feller spent nearly a day at the bank conferring with three or four officials and drawing documents to give the bank collateral in the form of Lotz's equity in the unearned premiums reserve (R. 952, 953) and by the fact that on September 21 and 27 Lotz's office teletyped Hart that they were working on the loan (R. 485, 487) and that in a teletype of September 28 Smead said, "Mr. Lotz and I were at the bank working on loan when you called and it is felt that loan will be consummated shortly." (R. 489.) As late as October 23, Smead teletyped "We have definite arrangements for loan." (R. 490.)

So we submit that on the basis of the written statements and testimony the trial court's finding that plaintiff failed to prove a conspiracy is amply supported. We come then to the course of dealing.

4. The Course of Dealing.

As we have stated, appellant argues that the premiums were trust funds but that even if they were not, defendants were guilty of fraud.

We will first discuss the character of the funds, and the legal consequences thereof. We contend that Lotz was a debtor rather than trustee as to premiums collected by him.

Lotz Was a Debtor as to Premiums and Therefore There Was No Diversion of Mid-States' Money.

While an insurance agent is ordinarily a trustee as to premiums, he becomes a debtor in respect thereto if the company permits him to mingle premium moneys with his own funds or otherwise use them inconsistently with a trust.

Downey v. Humphreys (1951), 102 C.A. 2d 323, 227 P. 2d 484;

Horton v. Eagle Indemnity Ins. Co. (1934), 86 N.H. 472, 171 A. 322;

Washington v. Covert (1896), 14 Wash. 352, 45 P. 304;

Twin City Fire Ins. Co. v. Green (1949), 176 F. 2d 532, 177 F. 2d 626;

Chicago Fire etc. Co. v. Fidelity etc. Co. (1933), 41 Ariz. 358, 18 P. 2d 260;

Manufacturers Cas. Ins. Co. v. Mink (1943), 129 N.J.L. 575, 30 A. 2d 510.

As an example of the rule, we quote from *Horton v. Eagle Indemnity Ins. Co.,* as follows (171 A. at p. 324):

> "Nor does the clause in one of the contracts that until remittance of the amount due premiums collected by the agency were to be held as the property of the insurer and 'as a fiduciary trust' make a difference here. The course of dealings between the parties shows a waiver or cancellation of the clause. The contract was in force for over three years, and the manner of payments and the business methods of the agency during the period were within the insurer's notice. The understanding and expectation of both parties that observance of the clause was to be ignored is thus decisively indicated. The practices employed by the agency and accepted by the insurer amounted to a parol alteration or cancellation of this term of the contract, and such a change is valid."

As shown by the decisions, this is so as between the parties despite the fact that the law and the agency agreement may provide that premiums are trust funds. It is a modification of the status as between the parties.

The dealings of Lotz with respect to Mid-States' premiums were radically and habitually inconsistent with a trust.

First, he used these premiums for his own purposes. This is the "float", which Hatfield described as "using someone else's money in the interim period before it is due". (R. 324.) In Lotz's case, it had existed from the beginning. His agency was a retrospective one, i.e., he could not take his commissions out of the premiums he collected, but he had to wait

until the premium was earned by the passage of time, and meantime he had to pay his operating expenses and commissions to sub-agents. Obviously, this required working capital. But Lotz had none, and he so advised Mid-States when his agency began. (R. 674, 675; 1173, 1174). Therefore, Mid-States knew he had to use their money. The evidence shows this. Richard Cass, executive of Mid-States when Lotz's original agency agreement with Mid-States was made, was asked in deposition: "* * * did the company know he used the money for operating expenses and paying any sub-agents?", and he answered: "There was knowledge of such facts, yes." (R. 1174.) Lotz explained it to Donnelly, Mid-States official who engaged him, who told Lotz: "You have got this length of time to pay your bills * * * you are using the company's money. That is the way the deal is set up." (R. 675.) Lotz mentioned it several times thereafter. (R. 680.) In 1948, 1949 and 1950 Lotz continued to operate on this float basis, without protest from Mid-States. (R. 684.) There was frequent inspection of Lotz's agency by visiting officials of Mid-States. (R. 676; 690 et seq.; 359.) In addition, Hatfield admitted that he knew in January 1951 that Lotz was paying sub-agents' commissions. (R. 353.)

The effect of this use by Lotz of premium moneys for operating expenses and sub-agents' commissions is demonstrated by Dfts' Exh. J, which shows the deficiency of cash in Lotz's accounts compared with his premium obligations to companies. (R. 969-972; 990-992.)

The result was that he was always delinquent in his remittances to Mid-States. Mid-States says he was at times delinquent ten days to two weeks. It was much longer than that. In 1950 three payments were 6 to 30 days late and *nine were 30 to 60 days late;* of the four payments from January to April, 1951, *three were 30 to 60 days late and one was over 60 days late;* and from April to September (when the credit period had been increased to 75 days) two payments were made within 5 days of the due date, one from 6 to 30 days late and *one 30 to 60 days late.* (Dfts' Exh. K; R. 973-975.) And the record shows letters and telegrams from Mid-States, almost monthly, sometimes three times monthly, demanding payments that were overdue. (Dfts' Exhs. A and F.)

Next is Lotz's method of handling funds. (R. 995-998.) He kept two accounts, trustee account and operating account. Into the trustee account went premiums received from sub-agents (usually after sub-agents' commissions were deducted), salvage and subrogation, and transfers from operating account. He drew on the trustee account to pay premiums, to make transfers to operating account, and to pay sub-agents' commissions where not previously deducted. He drew on operating account to pay his operating expenses and his own personal and living expenses. Commissions which he earned went into the operating account when he received them by check, and when they were received by way of credit against the account he owed a company, the credit was made to his trustee account. He put personal borrowings into the

operating account. And he made transfers back from operating to trustee account.

Such dealings were gravely inconsistent with trust. Paying sub-agents' commissions out of premiums was inconsistent with trust because on the trust theory the premiums would belong 100% to the company. Similarly the use of premium moneys for his operating expenses was inconsistent with trust.

Therefore, considering the way this agency was operated, it would do violence to the word *trust* to apply it to these premiums. It was *debt,* not *trust.* In fact, receipt of the premiums is not what gave rise to the obligation from Lotz to Mid-States. The company kept no track of Lotz's *receipt of premiums,* nor were they concerned with that. Rather, a certain number of days after the close of the month in which *the business was written* Lotz owed the amount of the premium to the company.

From this follows the important consequence that if the funds were not trust funds they belonged to Lotz and he could use them to pay his obligations. In other words, if he could pay sub-agent commissions, rents, salaries, etc., he could pay other creditors, including American Fidelity.

The course of dealing points up another important consideration. It is erroneous to compare, as appellant does, premiums received by Lotz on Mid-States' business in a given month with money paid to that company in that month. From May 15, 1947 to May 1,

1951, Lotz had 25 days from the end of the month in which business had been written to remit to Mid-States; from May 1, 1951 to September 1, 1951, 75 days; thereafter, 60 days. Furthermore, he was habitually late in remitting, as shown above. And he was "kiting", i.e., using premium collections to pay obligations which had arisen out of prior business. In view of these facts, "money in" as against "money out" in a given month is an unwarranted comparison.

Still another important consideration remains. In view of the commingling of funds, it was impossible at any time to tell how much of the money in Lotz's possession should be credited to any company. (R. 998.) Apart from allocation of cash, even the respective amounts he owed companies were not currently ascertainable for lack of entries. (R. 617, 618.)

In response to this, Mid-States argues that the agency agreement prior to September 1, 1951 did not state that premiums were trust funds, but that the September 1st agreement did so. This, they say, served to change any previous arrangement between the parties as to the character of the funds.

The absence of a provision in Lotz's agency agreement prior to September 1 regarding the nature of the funds was not significant because the law itself (which is quoted in Mid-States brief, pp. 23, 24) provided that they were trust funds. Both parties had known that law; yet Mid-States had let Lotz act otherwise. Therefore the trust clause in the September 1 contract added nothing.

The law provides that an insurance agent "who diverts or appropriates such fiduciary funds to his own use is guilty of theft". Is it conceivable that in spite of the way Mid-States permitted Lotz to deal with premiums—before or after September 1—it could have maintained that as between the parties Lotz was guilty of the felony of theft?

Another thing is that the September 1 agreement enumerated certain practices which it said would not destroy the trust character of the premiums, but the practices thus enumerated did not include the ones permitted by Mid-States which were inconsistent with trust. The practices listed in the September 1 agreement were (1) keeping the account on the company's books as a credit and debtor account, (2) alteration in compensation rate, (3) failure to enforce prompt remittance, and (4) compromise, settlement or declaration of balance of account. The agreement stated that none of those "shall be held to waive the understanding that the premiums collected by the agent are trust funds".

Those were not the practices which had destroyed the trust character of the funds in the Lotz agency. The permitted practices which had modified the trust were the use of the premiums for Lotz's own purposes, the commingling, etc. Nothing is said in the September 1 agreement concerning such practices.

There is nothing indicating any change after September 1 in Mid-States' attitude toward Lotz's habit of dealing with premiums, no admonition that the

practices of over four years were to be discontinued. Indeed, to do so would have been to terminate the agency, because Lotz could continue to operate on no other basis. Mid-States could justly be presumed to know this. In fact, by the September agreement, Mid-States granted Lotz a 15% prepaid commission because he told them that otherwise it would be difficult for him to shoulder the large volume of business it was then contemplated he would write for them. (R. 689, 694.) The conversation with Mid-States at Chicago which led to the September agreement was that Lotz was in trouble, that Mid-States was going to help him, that they would take all the business he could write, and that they would give him a new contract granting him a 15% prepaid commission. (R. 693-695.)

We submit that these facts substantiate the trial court's finding (R. 124) that premiums collected by Lotz after September 1 were of the same character as the previous ones, namely that they were not trust funds, but funds which belonged to Lotz. As such, he was entitled to use them to pay his obligations. Therefore Mid-States has failed to establish a right of action based on diversion of its money to others.

But they argue that the court's findings disregarded Lotz's fiduciary duties regarding aspects of his agency other than the accounting for premiums collected; and to that argument we now address ourselves.

Premiums Being Lotz's Money and Not Trust Funds, No Fraud Was Committed Against Mid-States.

Disregarding the contention that the premiums were trust funds, and considering them as money belonging to Lotz, what wrong was accomplished?

The writing of the increased amount of business for Mid-States was not wrong. Mid-States asked for it. (R. 318; 693-695.)

There was no concealment of the fact that Lotz wrote the business for them. He made daily reports of his underwritings (except for a few days delay in reporting the Public Service underwriting, which was due to secretarial work in typing multiple policies).

The loss ratio involved no wrong. It was 68.51% on the business written after September 1, 1951, and that was only 3.86% higher than that of the previous part of the year, and it was much better than the loss ratio on the business Lotz wrote for American Fidelity, which was 79.51%. (Dfts' Exhs. M and N; R. 979, 980.) In other words, the losses did not invade the 14% of the premium retained by Mid-States, and Mid-States got a better class of business than Lotz wrote for American Fidelity which is charged with having been in conspiracy with him against Mid-States.

What, then was wrong? For this, we will take up the various charges made by Mid-States.

They say that Lotz was insolvent August to October 1951, and that the defendants then knew he was but nevertheless plunged him into deeper insolvency, to Mid-States' loss. But this is not so. American

Fidelity did not make Lotz insolvent. It merely was paid what was owing to it, and payment of a debt does not create insolvency or add to it. Lotz's insolvency was increased by the large underwritings for Mid-States, and Mid-States knew about that and encouraged it. Besides, the portrait of Lotz's insolvency is that of today, not of then. *Then* he did not have financial statements, because his books were not posted and, as Hatfield said, were in "deplorable condition". True he was short of cash, but he did not know he would be unable eventually to pay his obligations or continue in business. He had an equity in large unearned premium reserves. He was to increase his volume and get a prepaid commission on it. He hoped to get a bank loan. His attorney, Mead, had worked out a "target plan" involving reduction of expenses, subagents' commissions and loss ratio. This was communicated on November 24 in Oakland to Hatfield and other representatives of Mid-States. (R. 1007, 1008.) The result was that on November 27 Lotz gave Mid-States the letter (Plf's Exh. 6; R. 230-232) in which he appointed Mid-States' representative Kledzik "to be my general manager with full power and authority to run my agency" and in which he agreed to the economies referred to in Mead's target plan. The letter was dictated not by Mead but in large part by Hatfield and Czar. It was accompanied by an assignment. Hatfield and Czar then stated that if the plan were put in effect the Lotz agency would in their opinion, within twelve months, and certainly not to exceed twenty-four, be completely in the black. (Tes-

timony of Mead, R. 1009, 1013.) Hatfield himself testified he then thought the situation could be worked out and that Mid-States would try to help.[4] (R. 379.)

Against this, appellant presents various arguments which we think were arguments for the trial court, not for this court after adverse findings below based on substantial evidence. But we will mention them briefly.

They say that prior to August a check of Lotz to American Fidelity for $53,301.00 had been returned unpaid. But it turned out that incoming checks, against which Lotz's check was drawn, had not yet cleared, and Lotz's check was eventually honored. (R. 761.)

They say that by Lotz's agreeing to pay his indebtedness to American Fidelity by September 15 he was accelerating the due date. There was no wrong in this. What they did was terminate the agency agreement with its credit period and set up a liquidation schedule. That was purely a matter of contract between them and they could do as they wished. Besides, American Fidelity did not get paid by September 15, nor did it expect to, the date being purely "psychological". (R. 808.)

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[4]Mid-States argues as if this were a *proposed plan* which never went into effect. The November 27 letter, which was dictated chiefly by Mid-States' officials, shows differently. In it Lotz says he has "as of this date" hired Kledzik as his manager, etc.; and Lotz testified that he was paid a salary and expenses "for a month or so", and also: "The checks were handed to me. I was paid that." (R. 648.) It was cancelled a short time later by Titus, but it did go into effect November 27.

They argue that Lotz paid large advance commissions to sub-agents while insolvent. But that is the way he had been getting his business all along, these commissions in 1951 amounting to 26% on Mid-States' business and to 26.7% on all companies represented by Lotz. (R. 994, 995.) This responds also to their complaint that Lotz paid a commission of 25% on the Public Service business; that was 1% *less* than the average sub-agent commissions paid by him.

Mid-States argues that on August 13 the amount of premiums which remained uncollected by Lotz on business which he had written for American Fidelity was less than the amount he owed American Fidelity. But there were other sources of funds then in prospect to make up the difference; these included commission income anticipated by Lotz (with a 15% prepaid commission from Mid-States), his equity in large unearned premium reserves and the prospect of a bank loan. Moreover, for this action the facts must be viewed as of then, not as of now, and to determine the state of mind of parties at that time it is a fallacy to quote figures and data developed by subsequent accounting and events.

They argue that a tape was run showing an excess of payables over premiums receivable. Hart testified it was not shown to him. (R. 847.) Anyhow, it ignores other resources such as his equity in premium reserves, anticipated prepaid commissions on increased volume, and bank loan then being negotiated. It also ignores the state of Lotz's books. It disregards also the fact that even in November Hatfield thought Lotz

would be able to work it out. The error is to impute present knowledge to persons in the situation then existing. To charge fraud is serious, and to say the least the events must be viewed in their context of contemporary circumstances, knowledge and intent.

Moreover, Mid-States, which is the complaining party here, must have known that Lotz habitually operated with a balance sheet deficit because of his kiting which they permitted him to engage in, and therefore that the fatal thing was to stop him.

Public Service Rewrite.

As a part of its argument on this point, Mid-States treats separately the Public Service rewrite and presents a variety of arguments on it. They argue that Lotz received only 75% of the premium but had to pay 85% of it to Mid-States. But he had been paying such commissions all along while owing *100%* of the premium to the companies. He had been doing this by virtue of the "float" which Mid-States had told him to use from the beginning; and he had commission income accruing from prior business.

They say the Public Service business was sub-standard. But the insurance he had written for Mid-States had been chiefly sub-standard. (R. 300.) They also complain that he had never done a rewrite like this before. But there was nothing in his contract which made a rewrite improper. They say Lotz did not discuss it with Hatfield until it was written. His contract did not require him to do so, and he never got Mid-States' approval before he wrote insurance

for them. Lotz so testified (R. 700, 701) and added, "I operate almost as a company, with full authority. I had a right to reject or accept any applicant and I operated on that basis. I operated almost the same as a company with full power to do about anything we wished".

They argue that Lotz was acting for adverse parties without disclosing the facts to permit Mid-States to judge regarding the transaction. He was acting as agent for Mid-States, within his powers as such agent. And Mid-States knew he was also agent for other companies. The underwriting was not initiated by American Fidelity. (R. 775; 442; 443.) Lotz disclosed the underwriting in his reports to Mid-States.

Finally, they contend that substantially all the premiums on the rewrite were paid to American Fidelity and that American Fidelity knew the source of the money and Mid-States' right to the funds.

The first answer to this is that even if these premiums were traceable to American Fidelity, it would not give rise to a cause of action because that would presuppose that the premiums were trust funds. We submit that they were not trust funds, and not being so, they belonged to Lotz and he could use them to pay his obligations.

But they have not even traced the funds as they say they have. Mid-States says (its brief, p. 11) that of $96,000 of Public Service premiums, $90,000 were paid to American Fidelity; and Anglo says (its brief, p. 24) that substantially all were so paid. The record

shows $53,000 traced in this way, not $90,000;[5] and the trial court did not find, as Anglo says, that "the bulk" of the Public Service money was paid to American Fidelity, but a "part" thereof. (R. 130.)

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[5]The only items traced by Mid-States in the evidence are two Public Service premiums received by Lotz, and two payments made by him to American Fidelity which they attribute in part to these receipts. The figures are contained in Lotz's account with Anglo for September. (Plf's Exh. 23.) Mr. Horton, Mid-States' auditor, located the two items of Public Service premiums as $5,547.25 included in the deposit of $14,790.16 on September 7 and $67,500 in the deposit of $68,811.84 on September 14. He identified the two payments to American Fidelity as $15,000 on September 11 and $60,000 on September 17. But in trying to trace the outgoing money to the incoming, all incoming money not identified as Mid-States' must be allowed for, and all outgoing payments not connected with American Fidelity must likewise be allowed for, because the burden is on Mid-States as the party doing the tracing.

The results, then, are these: On September 11 Lotz paid American $15,000. How much of that is traceable to Mid-States? There was $3,009.70 of unidentified money in the account on September 7. Then $14,790.16 was deposited, of which only $5,547.25 was connected with Mid-States, so $9,242.91 of that deposit was unidentified money. On September 11, $1,062.64 of unidentified money was deposited. This makes a total of $13,315.25 of unidentified money in the account when the $15,000 was paid to American, from which the conclusion follows that not more than $1,684.75 are shown to be attributable to Public Service premiums. (We ignore four expenditures totalling $1,429.19 on September 7, because they are unidentified and therefore no more chargeable to American than to Mid-States.)

Doing the same with the other two items: On September 13 there was $2,079.82 in the account. There was then deposited $68,811.84, of which $67,500 was Public Service, leaving $1,311.84 unidentified. On September 14, $4,951.98, unidentified, was deposited. The total of unidentified money is therefore $8,343.64. American was then paid $60,000, of which the balance, or $51,656.36, is all that is traceable to the Public Service premiums. This makes $53,341.11 traced in this way to Mid-States, not $90,000.

Anglo attempts to trace through testimony a portion of a $15,000 payment to American Fidelity on September 26, but the bank statement for that period was not introduced and the purported tracing is basically vitiated for failure to make allowance for unidentified money as in the cases of the other checks above mentioned.

But the tracing is not valid. Premiums collected by Lotz on Mid-States insurance were not earmarked as belonging to Mid-States. In fact he did not collect the full premium but only the net after commission. Sixty days after the close of the month in which insurance was written Lotz owed Mid-States an amount equal to the premium, regardless of what he collected. It was debt; not the mere transmission of someone else's money.

Even if these Public Service premiums had been trust funds, it would be fallacious to pick them out of the whole course of dealing and try to trace them to American Fidelity. If premiums were to be traced as belonging to a given company, the only proper procedure would be to go back to the beginning when Lotz began his operations for both companies and adjust his account with both companies on every transaction. That is, every time he paid a dollar of premium money for sub-agents' commission or expenses it would have to be allocated to see how much of each company's money he got (and he represented other companies besides Mid-States and American Fidelity (R. 621) and their interests would also have to be considered). Every time any of his own funds went into the account (by transfer from operating account or crediting of commissions) such amount would also have to be allocated to see how much should be credited to each company. Every time he paid any company anything, another adjustment would have to be made, because he paid per billings, not per the actual state of the companies' account. On

an actual tracing of the jumbled transactions, it would doubtless be found that Mid-States had received some money traceable to American Fidelity premiums and this would have to be offset against any Public Service money which came to American Fidelity in the period mentioned.[6]

Of course, in view of the indiscriminate commingling by Lotz, such a real, over-all tracing would have been so complicated as to be impractical—*but,* that being so, it is fallacious to pick out a very small segment of the dealing and to purport to do a tracing job on that segment to the neglect of the rest of the dealing.

Leaving the Public Service transaction and looking at the course of dealing as a whole, there is another important consideration to mention. Running through the entire argument of Mid-States is the contention that Mid-States was unaware of the insolvency and was therefore a victim of its agent's acts. But the trial court found differently. It found that Mid-States was to a great extent responsible for its loss and for the activities of Lotz which caused the loss. (R. 125.) This finding was based on more particular facts found by the court (R. 120-125) and supported by the evidence, namely—that Mid-States had advised Lotz from the beginning that since he had no capital and was on a retrospective commission basis, he could use

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[6]When Lotz began to write for American Fidelity, he did not *abandon* Mid-States. In fact from January to August, 1951, while he wrote $340,000 for American Fidelity, he also wrote $140,000 for Mid-States. (Plf's Exh. 23, p. 13.)

premiums for his expenses; that they regarded him as an independent contractor in keeping his books and bank account; that he handled premiums as his own money and was permitted to act as a debtor; that he was known by Mid-States to be inexperienced and unreliable as an insurance agent, Titus having said he had "to be watched very carefully on a day to day basis", and "If we can't get better representation in California than Joe Lotz, we will never stay out of trouble" (R. 735; 351); that he was habitually late in remitting to Mid-States and had to be continually pressed for payments; that his expenses and sub-agents' commissions in 1951 totalled over 40% and his loss ratio over 64%; and that, in spite of these facts, Mid-States urged him to write more business for it, which business was written and currently reported to it.

Mid-States cites the doctrine that a principal's neglect of his affairs is no excuse for similar neglect by his agent, and then says (p. 49), "In this case, of course, there is no claim whatsoever that Mid-States was itself negligent in attending to its business". This is a gross error, because this point was an issue in the case on which evidence was presented, argument was offered and findings were made. The fact is that Mid-States was not only negligent, but more than negligent. With the facts of which it was aware, it must have known that two things would render Lotz insolvent: causing him to increase his writings, and then stopping him, which terminated the kiting. Its action was therefore a deliberate disregard

of consequences which is explainable only on the ground that it was trying to get Lotz back and was willing to take the risks in the hope of ultimately favorable results.

They say the trial judge found that Lotz was a sick man and an inefficient agent and that from this it appeared that the trial judge thought Mid-States would not be entitled to recover if a breach were due to such factors. The inference as to the trial court's reasoning is not warranted. The factors mentioned were cited by the court as bearing upon the reliability of Lotz's statements and on the responsibility of Mid-States for its loss since it was aware of Lotz's condition.

They say that since the trial court found that Lotz's sole object was to pay his debts and stay in business, the trial court failed to realize that though motivation may be good, fraudulent intent as to the means may still exist. We reply that the trial court found, both generally and in detail, that defendants here were not guilty of fraud.

Mid-States says that Lotz had been guilty of no misconduct and was paid up with them up to August, 1951. But, as it also says, he was insolvent on August 1, 1951. Thus the reason he had paid Mid-States was that he was kiting, operating on the float. And while Mid-States is correct in saying that he had been guilty of no misconduct in the period mentioned, that is because his method of operations had been with its consent.

In view of these considerations, we look again at Mid-States' charge that being insolvent, Lotz wrote large amounts of insurance for Mid-States and used the premiums to pay another creditor, leaving the loss with Mid-States; and we say that if we eliminate accounting for premiums as trust funds, the charge falls. What he did with the premiums is an essential part of the charge. And the premiums not being trust funds, the tracing of any of them to American Fidelity is not actionable. A debtor may pay one creditor in preference to another even though he is insolvent. *California Civil Code,* Sec. 3432; 8 *Cal. Jur.* 1056.

The point is that trust is a serious matter. If one wants another to be one's trustee, one must act accordingly. In such case, rigid results follow. The beneficial title to the money is in the beneficiary, and the trustee has a bare legal title, burdened with strict duties of segregation, preservation against use by the trustee for his own purposes, and so on. Relax this earmarking; permit the trustee to commingle and use as his own; and radical results follow. The fund is no longer a trust fund; it belongs to the other person and it is available for his uses.

This does not visit an unjust penalty on the company. The company has freely chosen a course of dealing, from which the result follows. It cannot make that free choice, and then seek legal relief when a loss occurs.

We now take up the remaining contentions of Mid-States.

The American Fidelity Rewrite.

It says that it was induced by misrepresentations of Hart to agree to rewrite $61,000 of American Fidelity insurance. It cites two statements made by Hart to Hatfield in the telephone conversation in which the agreement was made. The first was this. Hatfield said, "You didn't kick them out, I know that". Hart replied, "* * * no, we didn't kick them out. Of course not." (R. 222.) They argue that this was a misrepresentation. But in fact in New York on August 13 Lotz had asked Hart for a prepaid commission, which had been refused because under its management contract with American Fidelity, American Plan could not grant a prepaid commission. (R. 764.) So Lotz went to Chicago and got a prepaid commission from Mid-States. Lotz's letter to American Plan so states; it says, "Pursuant to my discussion with your Mr. Hart in New York on August 13, 1951, and particularly in view of your inability to comply with my request for a pre-pay commission, I hereby terminate my agency agreement with American Fidelity * * *" (R. 639). Hatfield initiated the topic, not by a question, but by the statement "You didn't kick them out, I know that." Hart merely acquiesced. And when Lotz was negotiating the prepaid deal with Mid-States in Chicago, he told them he had called on Hart in New York where he had tried to get a better deal and had failed. (R. 701.)

Mid-States also contends that Hart deceived Hatfield in saying that Lotz had written some insurance for American Fidelity in September, whereas such

writing had ceased in August. The statement was made on the telephone on the spur of the moment in answer to a question of Hatfield. Hatfield must have known it was mistaken because Lotz had written him September 8, "We are not sending the American Fidelity and Casualty Company any business whatsoever—you are getting it all." (R. 292.) The materiality is also very questionable, since Lotz had continued to write for American Fidelity until a few days prior to September, namely to August 22. (R. 895.)

The trial court in its opinion said (R. 112, 113):

> "The evidence discloses that this conversation took place on October 31, 1951. In order to understand the import of Hart's words, one must take into consideration that Mid-States was anxious to get all of Lotz's business, and that on September 8, 1951, Lotz had told Mid-States that his agency was no longer sending American Fidelity any business whatsoever.
>
> Taking into consideration the fact that Hart and Hatfield were both experienced business executives in large competing insurance companies, it is the court's view that Hatfield did not rely on Hart's representations. Additionally, the court carefully read the conversation between Hart and Hatfield, and gives little weight to the argument that Hart's words were fraudulently intended. The conversation had must be read with the entire record of the case in mind in order to give the words contained therein their proper perspective and significance."

We submit that the court's finding on this subject is supported by the record.

Control of the Agency.

Mid-States charges that American Fidelity took control of Lotz's agency. The liquidation agreement between Lotz and American Fidelity (Plf's Exh. 17; R. 456-460) contained this clause: "The Manager (American Plan) hereby appoints Ralph L. Smead as its representative and Lotz agrees that the said representative shall have full authority over the finances of the agency *and in connection with the matters referred to herein* subject to instructions of the Manager." (Emphasis supplied.)

The court found that this did not give Smead full control over the agency and its finances but only insofar as they related to American Fidelity and the payment of the debt to it. (R. 132.) This is indicated by the phrase "and in connection etc." in the agreement. It is also consistent with the other terms of the agreement which provide for payment of the debt and for various economies to be observed until the debt was paid, and with the provision that if Lotz defaulted under the agreement American Fidelity could exercise its right "to take over and vest in itself Lotz's records, use and control of expirations".

The Machado Case.

Appellant stresses *Machado v. Katcher,* where the court found a conspiracy to defraud existed. After considering that case, the trial court in its opinion herein said (R. 106):

> "Of great significance in the Machado case is the fact that there was testimony that the third party

(Lewis) knew that Machado and other creditors could not be paid. Further, a motive for favoring Lewis is indicated by the intimacy between Lewis, Katcher, Sr. and the corporation. For the purpose of distinguishing the instant case, it is the court's view that the defendants were not aware that Lotz's creditors could not be paid. Nor was any motive shown for Lotz to engage in a fraudulent plan, i.e., close relationship to Fidelity and Casualty; dislike of Mid-States. Lotz's sole intention as adduced by the court from the evidence in this case was to pay his debts, and thereby continue in business."

The *fraud* in the *Machado* case was further evidenced by giving the daughter of the seller a post-dated check without her realizing it.

Summing up, therefore, the situation is this. An insurance company hires a man as its agent under a contract whereby he has to pay all his expenses and the full amount of the premium and wait until the insurance runs out before he gets any income. They know he has no capital and they tell him he is to use premiums for his expenses—thereby transforming the obligation from trust to debt. The kiting creates a deficiency of assets in the agency. Owing to this deficiency he is habitually late in making his payments and the company has to put pressure on him for almost every payment. They inspect his business frequently. They know he is unreliable. They know his loss ratio. He shifts the major part of his business to another company. They want to get him back. To do that they give him concessions and ask for a large

amount of business. He writes the business and reports it to them. His insolvency increases. They stop him and liquidate him. They then seek to recover their loss from the other company, whom he paid. They charge that he and the other company plunged him into deeper insolvency, whereas the other company received only what was due it, and the insolvency of the agent was due to the manner in which the complaining company, in its desire to get back the agent, permitted him to act. Under these circumstances, we submit that there was neither a conspiracy to defraud nor acts otherwise giving rise to a cause of action by the insurance company which suffered the loss against the creditor who was paid. On the contrary, the loss was attributable to the manner in which the principal permitted the agent to operate.

The ultimate explanation of the case appears to lie in the fact that Mid-States was so determined to get Lotz's business that it knowingly took the risk, and, having lost, comes to court as an innocent, abused party seeking reimbursement from the vigilant creditor who was paid. That is the way it appeared to the trial judge, who, after hearing all the evidence, said (R. 113):

> "From a study of the entire record in this case the court concludes that plaintiff has not sustained the burden of proving a conspiracy to defraud between the defendants. The underlying factor which motivated both insurance companies in this case was to secure all the business possible in this State, and it was this anxiety for business which caused a great loss to one of them.

> The fundamental basis of plaintiff's case is the written statement of Smead, and Smead's word is impugned by his own admission of untruthfulness. The course of dealing between the parties discloses a method of handling the Lotz agency which was contrary to a trust relationship, and in the absence of a showing of a fraudulent conspiracy on the part of the defendants, plaintiff cannot prevail. Lotz in paying Fidelity and Casualty preferred the creditor who was vigilant and actively pursued collection of its debt."

Before leaving Mid-States' case, we take note of its complaint that the court did not give it judgment against Lotz for an undisputed balance. While we do not represent Lotz, it appears to us that the reason was that Mid-States sued him for fraud, not contract.

II.

THE ANGLO CASE.

A. THERE WAS NO CONSPIRACY TO DEFRAUD.

It was conceded by Anglo at the trial that its case against defendants depended upon the establishment of the charge of a basic conspiracy against Mid-States. In this respect Anglo's counsel stated:

> "If there was a conspiracy as has been alleged and which we believe there was, the Bank was a party injured in carrying out that conspiracy.
>
> * * * Any party injured in carrying out the conspiracy has a charge or claim against the parties who are responsible for that conspiracy." (R. 284, 285.)

The discussion on this point was closed as follows:

> "The Court. And unless this so-called conspiracy is established, counsel concedes that of course it wouldn't prevail. Am I correct in that?
>
> Mr. McCallum (attorney for Anglo). That is correct, your Honor."

Since the court found no conspiracy to defraud, we believe that Anglo's case falls on that ground alone.

But there are additional reasons for that result, which we will now discuss.

B. NO FRAUD WAS PRACTICED ON ANGLO.

Anglo presents this point as if it were a simple case of a principal denying to its agent authority to endorse checks and of a subsequent representation by the agent that he possessed the authority thus denied to him. But that does not correctly portray the situation. The facts were these:

On August 27, Lotz wrote Hatfield asking for a corporate resolution regarding his authority to endorse checks, saying that his bank (then Central Bank) wanted it. (R. 287, 288.) Before receiving a reply, Lotz changed his account from Central to Anglo. On September 5, Hatfield wrote Lotz, saying:

> "*I am not saying that we will not grant you authority* but I want to suggest that the simplest way to eliminate your problem would be for you to instruct whatever accounts you have who presently make their premium payment checks payable to Mid-States that instead such checks should be made payable to you. In this manner there

could be no question about your endorsing the checks and placing the funds in your trustee account." (R. 289; emphasis supplied.)

On September 8, Lotz replied, saying:

"Now, regarding my request for authority to endorse checks made payable to the Mid-States Insurance Company, we do not have very many like this, and those that we do have, we can have them made payable direct to me." (R. 291, 292.)

On September 10, Hatfield wrote Lotz supplementing his letter of September 5, saying:

"I overlooked giving you the most important reason in that letter as to why *we are reluctant* to grant you the authority you requested. That reason is that under our blanket bond we do not have any protection if we grant authority to any person not on our payroll to endorse checks." (R. 291; emphasis supplied.)

Therefore, while it is true that Hatfield did not affirmatively grant the authority requested, he did not deny it either. In fact, he expressly refrains from denying it and limits himself to saying he is *reluctant* to grant it because of the bond problem.

Besides, he made it clear that he did not want to prevent the funds from getting into Lotz's account, for he suggested that Lotz cause premium checks to be made payable to himself. Therefore the problem in respect of the manner of collecting the funds was one of form, not of substance.

Moreover, under his general agency agreement, Lotz had the right to endorse the checks. The agreement provided that Lotz was given "power and duty to collect, receive and receipt for premiums". (Plf's Exh. 2.) That was a bilateral contract which bound Mid-States as well as Lotz. The power and the duty to collect premiums carried with them the right to do what was necessary to make the collection, and if assureds insisted on making their checks payable to the principal the only way Lotz could collect the premiums as required by his contract was to endorse his principal's name. By making the endorsement, therefore, he was exercising a right which he would have possessed even if Hatfield had tried to deny him the power. This is especially true in view of the method of operations, whereby Lotz had the right to the use of the money during his credit period. To say otherwise would in effect mean that Lotz should have forwarded the checks to Mid-States in Chicago for their endorsement and return to him—all of which would have been a completely idle act.

The law is in harmony with this, because it is common doctrine that a general agent has the right to collect premiums on insurance written by him. The rule is stated in *Stuyvesant Ins. Co. v. Ayers Nat. Bank* (1932), 268 Ill. App. 395, at p. 401:

> "authority was expressly conferred upon the agency by the certificate of authority to collect and to receive the moneys due the insurance company * * *; and it seems apparent that the agency could not have collected the money represented by the premium checks, which they were authorized to collect, without indorsing the checks.

We conclude that the authority to indorse the name of the insurance company for the purpose of collecting the money was necessarily implied. Moreover, under the contract constituting the Corn Belt Agency the agent of the insurance company * * *, the Corn Belt Agency became a general agent of the insurance company; and as such general agent, possessed all the powers of a general agent. A general agent has implied power to do those things necessary and proper to be done to carry into effect the purpose and scope of the agency business and to transact the business of the principal for which an agent is constituted in the usual and customary way; and as the principal could and would usually have done if the principal had been present. (Authorities.)

General authority to conduct a business involving the acceptance of checks will of necessity involve implying authority to take and indorse such paper in the course of the business intrusted to the agent. 2 Corpus Juris, 629 (note a).

It may be further pointed out that one lawfully in the possession of a check may present it for payment; and payment to him will be valid; and the fact that it had not been indorsed by the owner is of no substantial importance if the person to whom payment is made was in fact the agent of the owner to receive payment; and the payment to such agent will be valid without indorsement. 1 Danielson Negotiable Instruments, Sec. 572-574. *Shaffner v. Edgerton,* 13 Ill. App. 132."

To endorse checks, Lotz used a stamp, as follows (Intervening Plf's Exh. 5):

PAY TO THE ORDER OF
THE ANGLO CALIFORNIA NATIONAL
BANK
90-22 OAKLAND MAIN OFFICE 90-22
AMERICAN FIDELITY & CASUALTY CO.
WEST AMERICAN INS. CO. of L.A.
MID - STATE INSURANCE CO.
JOE LOTZ, TRUSTEE

Mid-States knew he used this stamp. (R. 697, 698.)

In a conversation at the Central Bank, while Lotz was still banking there, Lotz's operations were discussed, and when someone asked whether Lotz had power to sign checks, Hatfield said "Yes". (R. 712.)

After receiving Hatfield's letter, Lotz tried to get checks payable to him. He testified, "I was trying to. I was trying to get every agent to make these checks payable to me." (R. 713.) At times he failed. In the case of one sub-agent, for example, a Chico man (a check of whom was involved in the Anglo case), Lotz would get one check representing premiums on policies in several companies for which Lotz was agent, but the sub-agent would make the check payable to *one of the companies.* Lotz said, "I had no time to run back and get those checks straightened out because the companies wanted money. So I put the stamp on them and deposited them, and I felt the general practice which I had been led to believe—I was general agent, with all the authority I had, that he could put the stamp on there, because they wanted my checks." (R. 713, 714.)

The trial court found that Lotz believed he had authority to endorse and that he and the other de-

fendants did not intend to deceive Anglo or believe that Anglo was being exposed to any liability and that no fraud was practiced on it. (R. 139.) We think that finding was substantiated by the facts.

Another reason why Anglo has no case is that it was not liable to Mid-States.

C. ANGLO WAS NOT LIABLE TO MID-STATES.

Anglo's claim against defendants was admittedly conditioned upon Anglo's being liable to Mid-States for accepting Lotz's endorsement of the checks payable to Mid-States. The pleadings show this. In action 31311 Mid-States sued Anglo on the checks, which totalled $99,021.10. (R. 3-7.) Anglo answered, setting up various defenses, including the defense that under his agency agreement Lotz had authority to receive premiums and endorse checks, that he had ostensible authority, and that Mid-States was estopped from denying the authority. (R. 24-34.) Anglo then filed in action 31311 a third party complaint against American Fidelity and the other appellees herein in which it repeated all the allegations of conspiracy which Mid-States had pleaded against defendants in action 31496 and alleged that it too was an object of that conspiracy and asked that if it were held liable to Mid-States on the checks it have judgment against defendants for the amount thereof. (R. 65; also 63, 64.) In action 31496 Anglo filed a complaint in intervention against defendants to the same effect as its third party complaint in action 31311. (R. 50-64.)

The reason why Anglo's claim against defendants was conditional on its being liable to Mid-States was

that if it were not so liable it would not have been damaged.

The issue of Mid-States against Anglo was first tried separately, before Judge Harris. Following the trial, the case was briefed and submitted. Pending submission and without a decision of the case, Anglo consented to a judgment against it for $37,500, which sum it is now trying to recover herein. Thus there has been no adjudication of Mid-States' claim against Anglo.

And that issue was not litigated in this trial. As Anglo's counsel said, "I am not trying to try the so-called Anglo case". (R. 669.)

In the suit *against it,* Anglo argued strenuously—and we think correctly—that it was not liable to Mid-States. In doing so, it asserted all the grounds above mentioned, i.e., that Lotz had the right under his contract to collect premiums and to endorse checks, that as a general agent he possessed such power, and that Mid-States was estopped to deny his authority by years of approving his conduct.[7]

From these facts we conclude that Anglo was not liable to Mid-States and on this ground also its suit against these appellees fails.

CONCLUSION.

The trial court has found no conspiracy. It has done so on evidence which was in large part in con-

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[7]Lotz had banked with Anglo for years, then had transferred his business to the Central Bank, and had just returned to the Anglo before the transactions in question.

flict. Conspiracy being a matter of intent or design, it is especially a matter for the trial court to determine. The burden of proof was on plaintiff. The evidence must be viewed most favorably to the trial court's conclusion that the burden was not met. As so viewed, it clearly substantiates the trial court's determination.

While Anglo's case falls with the ruling on conspiracy, it also falls because Lotz had authority to endorse checks, from which it follows that he practiced no deceit and Anglo was not liable to Mid-States and therefore not damaged.

In our brief in the trial court we pointed out that Mid-States' theory of damages was radically mistaken and that even if Mid-States had been entitled to recover, the damages recoverable could not have been more than $65,000. We still assert that, but the point is immaterial if the judgment of the trial court is affirmed, which we think it should be.

Dated, San Francisco, California,
November 14, 1955.

Respectfully submitted,
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